

PERAC AUDIT REPORT



Falmouth Contributory Retirement System

JAN. 1, 2004 - DEC. 31, 2006



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PERAC

COMMONWEALTH OF MASSACHUSETTS | PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION COMMISSION

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JOSEPH E. CONNARTON, *Executive Director*

May 16, 2008

The Public Employee Retirement Administration Commission has completed an examination of the Falmouth Retirement System pursuant to G.L. c. 32, § 21. The examination covered the period from January 1, 2004 to December 31, 2006. This audit was conducted in accordance with the accounting and management standards established by the Public Employee Retirement Administration Commission, in regulation 840 CMR 25.00. Additionally, all supplementary regulations approved by PERAC and on file at PERAC are listed in this report.

In our opinion, the financial records are being maintained and the management functions are being performed in conformity with the standards established by the Public Employee Retirement Administration Commission, with the exception of those noted in the findings presented in this report.

In closing, I acknowledge the work of examiners Martin J. Feeney and John Shea who conducted this examination, and express appreciation to the Board of Retirement and staff for their courtesy and cooperation.

Sincerely,



Joseph E. Connarton
Executive Director



EXPLANATION OF FINDINGS AND RECOMMENDATIONS

I. Cash/Bank Reconciliation

A review of the bank reconciliations during the audit period disclosed a number of unexplained variances between the adjusted bank balance and the general ledger dating back to 12/31/04. These variances continued to be unresolved through 12/31/05. These differences were never identified but were finally adjusted to agree with the general ledger during 2006.

In 2006, the Board opened a new checking account with Citizen's Bank while leaving the old Bank of America checking account open. There continued to be unexplained variances between the adjusted bank balance and the general ledger throughout this period. Finally, in 2007, the system closed the old Bank of America account and adjusted the unexplained variances to the general ledger.

Recommendation: The system must improve its procedures for reconciling its cash/bank activity and identifying differences between the bank and the general ledger. The treasurer shall be the custodian of the retirement system's funds according to G.L. c. 32, § 23 (2) (a). As custodian of the retirement fund, the treasurer is obligated to perform a monthly reconciliation of all retirement system cash accounts. This process is necessary to maintain proper internal control of the retirement system by segregating reconciliation duties. This process must be completed in a timely manner. The treasurer must be instructed to provide appropriate paperwork (bank statement, reconciliation, and outstanding check list) to the Retirement Board on a monthly basis for all operating accounts. A complete list of unpaid checks and similar reconciling items should be compiled and included with the monthly bank reconciliation. The check number, the date issued, the payee and the amount of the check are basic details that should be included as essential parts of a formal reconciliation provided to the retirement board. Any discrepancies with general ledger balances must be promptly identified and resolved. Any difference between the adjusted bank balance and the book balance should be researched and any adjustment should be promptly made to ensure that both the book and adjusted bank balances are in agreement.

Board Response:

The Falmouth Retirement Board has requested that the Treasurer attend the monthly board meetings to discuss the monthly reconciliation of all retirement system cash accounts. The Treasurer has agreed to attend the monthly meetings and to provide timely reconciliation statements to the Falmouth Retirement System so that any and all discrepancies will be promptly identified and resolved. Additionally, the Treasurer has agreed to provide the appropriate paperwork, as recommended by P.E.R.A.C., to the Falmouth Retirement System. Any discrepancies noted during the reconciliation will be promptly identified and resolved.

2. Lease Agreement

The Retirement Board signed a lease with the Town of Falmouth for the building the Board occupies at 744 Main Street on August 18, 2004 with an effective date of the lease to be February 1, 2004. The lease requires the Board to make two equal payments of \$7,312 on July 1 and January 1 of each year. Only one rent payment in the amount of \$1,901.87 was made in 2004. No payments for rent were made to the Town of Falmouth in 2005. A payment of \$19,498.68 was made to the town on March 16, 2006. \$4,874.68 of this payment was for a portion of the balance relating to

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

2004 and the total payment of \$14,624 due in 2005. No other payment due for the year 2006 was made.

The total amount due the Town of Falmouth for the years 2004 through 2006 is \$43,872. Total payments for this period were \$21,400.55. Although the lease does not provide for it, the Board has determined that the Leasehold Improvements of \$10,707.76 should be deducted from the rent due. There is a letter from the Assistant Town Administrator which indicates that such adjustments can be made. If these adjustments are acceptable, the Board owes a balance of \$11,763.69 to the Town for the period 2004 through 2006

Recommendation: The Board must review the lease agreement and payments made to determine definitively the additional rent due the town for the years 2004 through 2006. Payments should be rendered as soon as possible.

Board Response:

The retirement system staff is reviewing the lease agreement with a representative of the Town of Falmouth to determine and document which payments toward improvements to the property, if any, can be off-set against lease installment payments. Any and all past due lease payments to the Town of Falmouth will be approved by and paid by the Falmouth Retirement Board. The retirement system staff will maintain an accounting of all future payments that are credited towards the lease agreement, and all future lease payments will be paid promptly.

3. Expenses

Some expenses are being misclassified in the general ledger. An analysis of expenses showed that service contracts, consulting fees, management fees and insurance expense have been charged to incorrect accounts.

Recommendation: A review of the chart of accounts should be undertaken and a determination made as to which of the System's expenses should be charged to which accounts.

Board Response:

The retirement system staff has undertaken a review of the chart of accounts to determine which of the Falmouth Retirement System's expenses should be charged to which accounts. The staff will insure that, going forward, each year the Falmouth Retirement System's expenses are booked to the appropriate accounts.

FINAL DETERMINATION:

PERAC Audit staff will follow up in six (6) months to ensure appropriate actions have been taken regarding all findings.

STATEMENT OF LEDGER ASSETS AND LIABILITIES

AS OF DECEMBER 31,			
	2006	2005	2004
Net Assets Available For Benefits:			
Cash	\$3,042,885	\$5,093,717	\$3,240,952
Fixed Income Securities	11,609,987	11,709,531	16,864,713
Equities	15,740,067	21,346,288	27,470,884
Pooled Domestic Equity Funds	18,615,722	9,469,713	0
Pooled International Equity Funds	13,509,279	10,776,402	9,561,344
Pooled International Fixed Income Funds	2,163,940	2,029,952	0
Pooled Alternative Investment Funds	3,370,037	2,920,873	5,113,524
Pooled Real Estate Funds	7,016,929	6,149,513	2,287,927
PRIT Cash Fund	0	0	0
PRIT Core Fund	3,751,967	0	0
Interest Due and Accrued	117,229	108,350	156,588
Accounts Receivable	2,000,682	2,173,601	1,922,122
Accounts Payable	(241,102)	(238,635)	(170,858)
Total	<u>\$80,697,622</u>	<u>\$71,539,305</u>	<u>\$66,447,196</u>
Fund Balances:			
Annuity Savings Fund	\$21,364,201	\$20,285,921	\$18,564,775
Annuity Reserve Fund	5,911,490	5,622,076	5,501,446
Pension Fund	4,163,331	5,239,895	6,269,102
Military Service Fund	3,258	3,239	3,219
Expense Fund	0	0	0
Pension Reserve Fund	49,255,342	40,388,174	36,108,654
Total	<u>\$80,697,622</u>	<u>\$71,539,305</u>	<u>\$66,447,196</u>

STATEMENT OF CHANGES IN FUND BALANCES

	Annuity Savings Fund	Annuity Reserve Fund	Pension Fund	Military Service Fund	Expense Fund	Pension Reserve Fund	Total All Funds
Beginning Balance (2004)	\$17,271,281	\$5,184,539	\$7,412,666	\$0	\$0	\$30,743,396	\$60,611,882
Receipts	2,284,254	157,349	3,302,144	3,220	628,876	5,374,186	11,750,029
Interfund Transfers	(767,014)	767,014	0	0	0	0	0
Disbursements	(223,746)	(607,457)	(4,454,635)	0	(628,876)	0	(5,914,714)
Ending Balance (2004)	18,564,775	5,501,445	6,260,175	3,220	0	36,117,582	66,447,197
Receipts	2,670,899	161,935	3,767,867	19	701,119	4,279,519	11,581,358
Interfund Transfers	(669,250)	669,250	0	0	0	0	0
Disbursements	(280,503)	(710,555)	(4,797,073)	0	(701,119)	0	(6,489,250)
Ending Balance (2005)	20,285,921	5,622,075	5,230,969	3,239	0	40,397,101	71,539,305
Receipts	2,443,930	168,414	4,061,962	19	661,162	8,873,433	16,208,920
Interfund Transfers	(863,360)	863,360	0	0	0	0	0
Disbursements	(502,292)	(742,359)	(5,144,790)	0	(661,162)	0	(7,050,603)
Ending Balance (2006)	<u>\$21,364,199</u>	<u>\$5,911,490</u>	<u>\$4,148,141</u>	<u>\$3,258</u>	<u>\$0</u>	<u>\$49,270,534</u>	<u>\$80,697,622</u>

STATEMENT OF RECEIPTS

FOR THE PERIOD ENDING DECEMBER 31,			
	2006	2005	2004
Annuity Savings Fund:			
Members Deductions	\$2,209,125	\$2,122,851	\$1,970,510
Transfers from Other Systems	12,461	329,399	136,690
Member Make Up Payments and Re-deposits	65,805	109,219	76,219
Member Payments from Rollovers	39,563	0	0
Investment Income Credited to Member Accounts	116,976	109,430	100,835
Sub Total	<u>2,443,930</u>	<u>2,670,899</u>	<u>2,284,254</u>
Annuity Reserve Fund:			
Investment Income Credited to the Annuity Reserve Fund	<u>168,414</u>	<u>161,935</u>	<u>157,349</u>
Pension Fund:			
3 (8) (c) Reimbursements from Other Systems Received from Commonwealth for COLA and Survivor Benefits	91,115	96,839	95,241
	170,847	171,028	0
Pension Fund Appropriation	<u>3,800,000</u>	<u>3,500,000</u>	<u>3,206,903</u>
Sub Total	<u>4,061,962</u>	<u>3,767,867</u>	<u>3,302,144</u>
Military Service Fund:			
Contribution Received from Municipality on Account of Military Service	0	0	3,220
Investment Income Credited to the Military Service Fund	<u>19</u>	<u>19</u>	<u>0</u>
Sub Total	<u>19</u>	<u>19</u>	<u>3,220</u>
Expense Fund:			
Investment Income Credited to the Expense Fund	<u>661,162</u>	<u>701,119</u>	<u>628,876</u>
Sub Total	<u>661,162</u>	<u>701,119</u>	<u>628,876</u>
Pension Reserve Fund:			
Federal Grant Reimbursement	20,502	30,984	43,278
Interest Not Refunded	1,591	4,525	2,246
Miscellaneous Income	0	0	8,928
Excess Investment Income	<u>8,851,340</u>	<u>4,244,010</u>	<u>5,319,734</u>
Sub Total	<u>8,873,433</u>	<u>4,279,519</u>	<u>5,374,186</u>
Total Receipts	<u><u>\$16,208,920</u></u>	<u><u>\$11,581,358</u></u>	<u><u>\$11,750,029</u></u>

STATEMENT OF DISBURSEMENTS

FOR THE PERIOD ENDING DECEMBER 31,			
	2006	2005	2004
Annuity Savings Fund:			
Refunds to Members	\$331,213	\$154,784	\$158,276
Transfers to Other Systems	<u>171,079</u>	<u>125,719</u>	<u>65,470</u>
Sub Total	<u>502,292</u>	<u>280,503</u>	<u>223,746</u>
Annuity Reserve Fund:			
Annuities Paid	742,359	710,555	607,457
Option B Refunds	<u>0</u>	<u>0</u>	<u>0</u>
Sub Total	<u>742,359</u>	<u>710,555</u>	<u>607,457</u>
Pension Fund:			
Pensions Paid:			
Regular Pension Payments	3,540,331	3,319,190	3,107,029
Survivorship Payments	185,149	248,546	223,151
Ordinary Disability Payments	62,925	129,117	128,374
Accidental Disability Payments	1,095,869	951,453	896,131
Accidental Death Payments	105,557	97,702	73,188
Section 101 Benefits	43,076	0	0
3 (8) (c) Reimbursements to Other Systems	111,883	51,065	26,762
State Reimbursable COLA's Paid	0	0	0
Chapter 389 Beneficiary Increase Paid	<u>0</u>	<u>0</u>	<u>0</u>
Sub Total	<u>5,144,790</u>	<u>4,797,073</u>	<u>4,454,635</u>
Military Service Fund:			
Return to Municipality for Members Who Withdrew Their Funds	<u>0</u>	<u>0</u>	<u>0</u>
Expense Fund:			
Board Member Stipend	2,750	3,000	0
Salaries	106,727	146,530	134,797
Legal Expenses	7,245	12,028	1,193
Medical Expenses	0	422	57
Travel Expenses	1,375	1,593	669
Administrative Expenses	11,205	45,642	24,505
Furniture and Equipment	15,356	7,022	27,731
Management Fees	388,831	388,077	357,634
Custodial Fees	30,557	39,056	43,638
Consultant Fees	55,000	43,125	31,875
Rent Expenses	14,624	14,624	6,777
Service Contracts	23,575	0	0
Fiduciary Insurance	<u>3,917</u>	<u>0</u>	<u>0</u>
Sub Total	<u>661,162</u>	<u>701,119</u>	<u>628,876</u>
Total Disbursements	<u><u>\$7,050,603</u></u>	<u><u>\$6,489,250</u></u>	<u><u>\$5,914,714</u></u>

INVESTMENT INCOME

	FOR THE PERIOD ENDING DECEMBER 31,		
	2006	2005	2004
Investment Income Received From:			
Cash	\$136,475	\$85,339	\$7,947
Short Term Investments	0	0	1,603
Fixed Income	532,054	1,044,969	1,145,982
Equities	326,202	307,382	331,744
Pooled or Mutual Funds	54,330	40,279	208,208
Commission Recapture	0	13,421	1,201
Total Investment Income	<u>1,049,061</u>	<u>1,491,390</u>	<u>1,696,685</u>
Plus:			
Realized Gains	1,172,007	2,173,077	1,968,587
Unrealized Gains	10,407,629	4,852,395	5,172,550
Interest Due and Accrued on Fixed Income Securities - Current Year	<u>117,229</u>	<u>108,350</u>	<u>156,588</u>
Sub Total	<u>11,696,865</u>	<u>7,133,822</u>	<u>7,297,725</u>
Less:			
Paid Accrued Interest on Fixed Income Securities	(59,447)	(172,630)	(145,888)
Realized Loss	(788,262)	(1,807,603)	(1,411,864)
Unrealized Loss	(1,987,081)	(1,286,502)	(1,102,281)
Interest Due and Accrued on Fixed Income Securities - Prior Year	<u>(108,350)</u>	<u>(156,588)</u>	<u>(132,457)</u>
Sub Total	<u>(2,943,140)</u>	<u>(3,423,323)</u>	<u>(2,792,490)</u>
Net Investment Income	<u>9,802,786</u>	<u>5,201,889</u>	<u>6,201,920</u>
Income Required:			
Annuity Savings Fund	116,976	109,430	100,836
Annuity Reserve Fund	168,414	161,935	157,349
Military Service Fund	19	19	0
Expense Fund	<u>666,037</u>	<u>686,495</u>	<u>624,001</u>
Total Income Required	<u>951,446</u>	<u>957,879</u>	<u>882,186</u>
Net Investment Income	<u>9,802,786</u>	<u>5,201,889</u>	<u>6,201,920</u>
Less: Total Income Required	<u>951,446</u>	<u>957,879</u>	<u>882,186</u>
Excess Income To The Pension Reserve Fund	<u>\$8,851,340</u>	<u>\$4,244,010</u>	<u>\$5,319,734</u>

SCHEDULE OF ALLOCATION OF INVESTMENTS OWNED

(percentages by category)

AS OF DECEMBER 31, 2006			
	MARKET VALUE	PERCENTAGE OF TOTAL ASSETS	PERCENTAGE ALLOWED
Cash	3,042,885	3.9%	100%
Fixed Income	11,609,987	14.7%	45%
Equities	15,740,067	20.0%	65%
Pooled Domestic Equity Funds	18,615,722	23.6%	
Pooled International Equity Funds	13,509,279	17.1%	20%
Pooled International Fixed Income Funds	2,163,940	2.7%	3%
Pooled Alternative Investment Funds	3,370,037	4.3%	5%
Pooled Real Estate Funds	7,016,929	8.9%	10%
PRIT Cash Fund	0	0.0%	
PRIT Core Fund	3,751,967	4.8%	100%
Grand Total	<u>\$78,820,813</u>	<u>100.0%</u>	

For the year ending December 31, 2006, the rate of return for the investments of the Falmouth Retirement System was 13.93%. For the five-year period ending December 31, 2006, the rate of return for the investments of the Falmouth Retirement System averaged 7.73%. For the twenty-two year period ending December 31, 2006, since PERAC began evaluating the returns of the retirement systems, the rate of return on the investments of the Falmouth Retirement System was 10.58%.

SUPPLEMENTARY INVESTMENT REGULATIONS

The Falmouth Retirement System submitted the following supplementary investment regulations, which were approved by the Public Employee Retirement Administration Commission

October 12, 2001

- 17.04(1)(c) Exemption of the Board and INVESCO from the second sentence of 840 CMR 17.04(1)(c) –This Regulation deals with the use of non-public information by managers and consultants. PERAC recognizes that, in making the investments contemplated by the INVESCO Funds delineated above, that sentence, which prohibits action until information is publicly disseminated, represents an undue burden on the ability of the Partnerships to operate. Consequently, the Falmouth Retirement Board's request as it applies to 840 CMR 17.04(1)(c) is approved.
- 17.04(6) Exemption of the Board and INVESCO from 840 CMR 17.04(6), except as otherwise provided for in the Partnership Agreement and/or as disclosed in INVESCO's Form ADV – This Regulation deals with the Priority of Transactions and an investment manager's obligation to prioritize board transactions and provide the board with the opportunity to act prior to the manager acting, if applicable. PERAC recognizes that this Regulation may impede the ability of partnerships such as INVESCO's to operate. Upon receipt of a copy of the provisions of the Partnership Agreement and/or disclosures in the INVESCO Form ADV, the Commission will approve the Falmouth request as it applies to 840 CMR 17.04(6).
- 19.01(7)(a)(6) Exemption of the Board and INVESCO from 840 CMR 19.01(7)(a)(6) with respect to the management fees and the General Partner's Carried Interest to be received by the manager or the General Partner pursuant to the (a) Subscription Agreement, (b) Agreement as defined in the side letter, and/or (c) Manager's Investment Advisory Agreement with respect to the Board's commitments to the Partnerships – PERAC recognizes the fact that the market, at the present time, is such that fee limitations, as outlined in these Regulations, result in limiting the number of partnerships available to the retirement boards. Consequently, the Falmouth Retirement Board's request, as it applies to 840 CMR 19.01(7)(a)(6), is approved.

SUPPLEMENTARY INVESTMENT REGULATIONS (CONTINUED)

21.01(2) Exemption of the Board and INVESCO from 840 CMR 21.01(2), 21.01(3)(a) 21.01(4), and 21.01(5) to the extent as otherwise permitted under the applicable agreement – These Regulations prohibit certain transactions as follows: 21.01(2) prohibits the sale of securities not owned by the system at the time of the sale (short sales); 21.01(3)(a) permits the use of forward currency contracts in limited circumstances; 21.01(4) prohibits the use of call options; 21.01(5) prohibits the purchase of options other than as required to close out option positions. PERAC has received a letter dated August 22, 2000 from INVESCO that clarifies the possible use of options, futures, or other derivatives. In pertinent part, the letter states as follows: “Although the above referenced funds do not expect to use options, futures, or other derivatives other than infrequently, if at all, futures and/or options would be used only for nonspeculative true hedging purposes. In general, we would anticipate their use, if at all, for among other reasons to protect downside risk on public securities of companies distributed to the funds by the underlying portfolio funds we invest in and where a commitment to a fund was made in a non US currency to limit currency risk of the funds.”

August 31, 2001

16.08 In accordance with PERAC Investment Guideline 99-2, the Falmouth Retirement System is modifying its international growth equity mandate with State Street Global Advisors to allow for securities lending. There is no change in the fund’s investment strategy, investment universe, or benchmark. The Board understands and is comfortable with the practice of securities lending and is satisfied with State Street Bank’s capabilities in this area.

August 8, 2000

16.08 In accordance with PERAC Investment Guideline 99-2, the Falmouth Retirement Board may modify its investment mandate with Cutler & Company, its domestic large cap equity manager, to allow for the opportunistic use of mid cap equities when and as deemed appropriate by the manager. The Board has had a successful relationship with Cutler & Company since 1997 and is confident, based on the manager’s performance record, that it can effectively accomplish the modified, slightly expanded, mandate.

SUPPLEMENTARY INVESTMENT REGULATIONS (CONTINUED)

May 1, 2000

16.08 In accordance with PERAC Investment Guideline 99-2, the Falmouth Retirement Board may modify its fixed income mandate with Freedom Capital Management to allow the opportunistic investment of up to 15% of the account in high-yield securities. The Board wishes to have exposure to this sub-class and has had a satisfactory relationship with Freedom Capital for over two years as its fixed income manager.

August 8, 1996

16.02(3) The board may incur expenses for investment advice or management of the funds of the system by a qualified investment manager and the board may incur expenses for consulting services. Such expenses may be charged against earned income from investments provided that the total of such expenses shall not exceed in any one year:

- (a) 1% of the value of the fund for the first \$5 million, and
- (b) 0.5% of the value of the fund in excess of \$5 million.

October 19, 1995

18.02(4) Rate of Return: A statement of the rate of return objective for the entire portfolio which shall be at least one percent (100 basis points) greater than a composite performance index consisting of 55% of the Standard and Poors "500" Stock Index and 45% of the Shearson Lehman Government/Corporate Bond Index, cumulated quarterly.

February 18, 1993

20.03(1) Equity investments shall not exceed 65% of the total book value of the portfolio at the time of purchase.

SUPPLEMENTARY INVESTMENT REGULATIONS (CONTINUED)

March 27, 1991

20.04 All investments shall consist of recognized quality marketable securities issued by: (1) United States based corporations and fixed income and equity securities of non-U.S. based corporations, provided that: (a) all such fixed income securities are denominated in U.S. currency and issued and traded in U.S. markets and provided further that the total of all such fixed income securities shall be considered part of the board's fixed income asset allocation and shall not exceed 10% of the total market value of the fixed income portfolio; and (b) all such equity securities are denominated in U.S. currency and issued and traded in U.S. markets and provided further that the total of such equity securities shall be considered part of the board's equity asset allocation and shall not exceed 10% of the total market value of the equity portfolio.

NOTES TO FINANCIAL STATEMENTS

NOTE I – SUMMARY OF PLAN PROVISIONS

The plan is a contributory defined benefit plan covering all Falmouth Retirement System member unit employees deemed eligible by the retirement board, with the exception of school department employees who serve in a teaching capacity. The Teachers' Retirement Board administers the pensions of such school employees.

ADMINISTRATION

There are 106 contributory Retirement Systems for public employees in Massachusetts. Each system is governed by a retirement board, and all boards, although operating independently, are governed by Chapter 32 of the Massachusetts General Laws. This law in general provides uniform benefits, uniform contribution requirements, and a uniform accounting and funds structure for all systems.

PARTICIPATION

Participation is mandatory for all full-time employees. Eligibility with respect to part-time, provisional, temporary, seasonal, or intermittent employment is governed by regulations promulgated by the retirement board, and approved by PERAC. Membership is optional for certain elected officials.

There are 3 classes of membership in the Retirement System:

Group 1:

General employees, including clerical, administrative, technical, and all other employees not otherwise classified.

Group 2:

Certain specified hazardous duty positions.

Group 4:

Police officers, firefighters, and other specified hazardous positions.

NOTES TO FINANCIAL STATEMENTS (Continued)

MEMBER CONTRIBUTIONS

Member contributions vary depending on the most recent date of membership:

Prior to 1975:	5% of regular compensation
1975 - 1983:	7% of regular compensation
1984 to 6/30/96:	8% of regular compensation
7/1/96 to present:	9% of regular compensation
1979 to present:	an additional 2% of regular compensation in excess of \$30,000.

RATE OF INTEREST

Interest on regular deductions made after January 1, 1984 is a rate established by PERAC in consultation with the Commissioner of Banks. The rate is obtained from the average rates paid on individual savings accounts by a representative sample of at least 10 financial institutions.

RETIREMENT AGE

The mandatory retirement age for some Group 2 and Group 4 employees is age 65. Most Group 2 and Group 4 members may remain in service after reaching age 65. Group 4 members who are employed in certain public safety positions are required to retire no later than the end of month they attain age 65. There is no mandatory retirement age for employees in Group 1.

SUPERANNUATION RETIREMENT

A member is eligible for a superannuation retirement allowance (service retirement) upon meeting the following conditions:

- completion of 20 years of service, or
- attainment of age 55 if hired prior to 1978, or if classified in Group 4, or
- attainment of age 55 with 10 years of service, if hired after 1978, and if classified in Group 1 or 2

NOTES TO FINANCIAL STATEMENTS (Continued)

AMOUNT OF BENEFIT

A member's annual allowance is determined by multiplying average salary by a benefit rate related to the member's age and job classification at retirement, and the resulting product by his creditable service. The amount determined by the benefit formula cannot exceed 80% of the member's highest three year average salary. For veterans as defined in G.L. c. 32, § 1, there is an additional benefit of \$15 per year for each year of creditable service, up to a maximum of \$300.

- Salary is defined as gross regular compensation.
- Average Salary is the average annual rate of regular compensation received during the 3 consecutive years that produce the highest average, or, if greater, during the last three years (whether or not consecutive) preceding retirement.
- The Benefit Rate varies with the member's retirement age, but the highest rate of 2.5% applies to Group 1 employees who retire at or after age 65, Group 2 employees who retire at or after age 60, and to Group 4 employees who retire at or after age 55. A .1% reduction is applied for each year of age under the maximum age for the member's group. For Group 2 employees who terminate from service under age 55, the benefit rate for a Group 1 employee shall be used.

DEFERRED VESTED BENEFIT

A participant who has completed 10 or more years of creditable service is eligible for a deferred vested retirement benefit. Elected officials and others who were hired prior to 1978 may be vested after 6 years in accordance with G.L. c. 32, § 10.

The participant's accrued benefit is payable commencing at age 55, or the completion of 20 years, or may be deferred until later at the participant's option.

WITHDRAWAL OF CONTRIBUTIONS

Member contributions may be withdrawn upon termination of employment. Employees who first become members on or after January 1, 1984, may receive only limited interest on their contributions if they voluntarily terminate their service. Those who leave service with less than 5 years receive no interest; those who leave service with greater than 5 but less than 10 years receive 50% of the interest credited.

NOTES TO FINANCIAL STATEMENTS (Continued)

DISABILITY RETIREMENT

The Massachusetts Retirement Plan provides 2 types of disability retirement benefits:

ORDINARY DISABILITY

Eligibility: Non-veterans who become totally and permanently disabled by reason of a non-job related condition with at least 10 years of creditable service (or 15 years creditable service in systems in which the local option contained in G.L. c. 32, § 6(1) has not been adopted).

Veterans with ten years of creditable service who become totally and permanently disabled by reason of a non-job related condition prior to reaching “maximum age”.

Retirement Allowance: Equal to the accrued superannuation retirement benefit as if the member was age 55. If the member is a veteran, the benefit is 50% of the member’s final rate of salary during the preceding 12 months, plus an annuity based upon accumulated member contributions plus credited interest. If the member is over age 55, he or she will receive not less than the superannuation allowance to which he or she is entitled.

ACCIDENTAL DISABILITY

Eligibility: Applies to members who become permanently and totally unable to perform the essential duties of the position as a result of a personal injury sustained or hazard undergone while in the performance of duties. There are no minimum age or service requirements.

Retirement Allowance: 72% of salary plus an annuity based on accumulated member contributions, with interest. This amount is not to exceed 100% of pay. For those who became members in service after January 1, 1988 or who have not been members in service continually since that date, the amount is limited to 75% of pay. There is an additional pension of \$667.92 per year (or \$312.00 per year in systems in which the local option contained in G.L. c. 32, § 7(2)(a)(iii) has not been adopted), per child who is under 18 at the time of the member’s retirement, with no age limitation if the child is mentally or physically incapacitated from earning. The additional pension may continue up to age 22 for any child who is a full time student at an accredited educational institution.

NOTES TO FINANCIAL STATEMENTS (Continued)

ACCIDENTAL DEATH

Eligibility: Applies to members who die as a result of a work-related injury or if the member was retired for accidental disability and the death was the natural and proximate result of the injury or hazard undergone on account of which such member was retired.

Allowance: An immediate payment to a named beneficiary equal to the accumulated deductions at the time of death, plus a pension equal to 72% of current salary and payable to the surviving spouse, dependent children or the dependent parent, plus a supplement of \$312 per year, per child, payable to the spouse or legal guardian until all dependent children reach age 18 or 22 if a full time student, unless mentally or physically incapacitated.

The surviving spouse of a member of a police or fire department or any corrections officer who, under specific and limited circumstances detailed in the statute, suffers an accident and is killed or sustains injuries resulting in his death, may receive a pension equal to the maximum salary for the position held by the member upon his death.

In addition, an eligible family member may receive a one time payment of \$100,000 from the State Retirement Board.

DEATH AFTER ACCIDENTAL DISABILITY RETIREMENT

Effective November 7, 1996, Accidental Disability retirees were allowed to select Option C at retirement and provide a benefit for an eligible survivor. For Accidental Disability retirees prior to November 7, 1996, who could not select Option C, if the member's death is from a cause unrelated to the condition for which the member received accidental disability benefits, a surviving spouse will receive an annual allowance of \$6,000.

DEATH IN ACTIVE SERVICE

Allowance: An immediate allowance equal to that which would have been payable had the member retired and elected Option C on the day before his or her death. For death occurring prior to the member's superannuation retirement age, the age 55 benefit rate is used. The minimum annual allowance payable to the surviving spouse of a member in service who dies with at least two years of creditable service is \$3,000, provided that the member and the spouse were married for at least one year and living together on the member's date of death.

The surviving spouse of such a member in service receives an additional allowance equal to the sum of \$1,440 per year for the first child, and \$1,080 per year for each additional child until all dependent children reach age 18 or 22 if a full time student, unless mentally or physically incapacitated.

NOTES TO FINANCIAL STATEMENTS (Continued)

COST OF LIVING

If a system has accepted Chapter 17 of the Acts of 1997, and the Retirement Board votes to pay a cost of living increase for that year, the percentage is determined based on the increase in the Consumer Price Index used for indexing Social Security benefits, but cannot exceed 3.0%. Section 51 of Chapter 127 of the Acts of 1999, if accepted, allows boards to grant COLA increases greater than that determined by CPI but not to exceed 3.0%. The first \$12,000 of a retiree's total allowance is subject to a cost-of-living adjustment. The total Cost-of-Living adjustment for periods from 1981 through 1996 is paid for by the Commonwealth of Massachusetts.

METHODS OF PAYMENT

A member may elect to receive his or her retirement allowance in one of 3 forms of payment.

Option A: Total annual allowance, payable in monthly installments, commencing at retirement and terminating at the member's death.

Option B: A reduced annual allowance, payable in monthly installments, commencing at retirement and terminating at the death of the member, provided, however, that if the total amount of the annuity portion received by the member is less than the amount of his or her accumulated deductions, including interest, the difference or balance of his accumulated deductions will be paid in a lump sum to the retiree's beneficiary or beneficiaries of choice.

Option C: A reduced annual allowance, payable in monthly installments, commencing at retirement. At the death of the retired employee, 2/3 of the allowance is payable to the member's designated beneficiary (who may be the spouse, or former spouse who remains unmarried for a member whose retirement becomes effective on or after February 2, 1992, child, parent, sister, or brother of the employee) for the life of the beneficiary. For members who retired on or after January 12, 1988, if the beneficiary pre-deceases the retiree, the benefit payable increases (or "pops up") based on the factor used to determine the Option C benefit at retirement. For members who retired prior to January 12, 1988, if the System has accepted Section 288 of Chapter 194 of the Acts of 1998 and the beneficiary pre-deceases the retiree, the benefit payable "pops up" in the same fashion. The Option C became available to accidental disability retirees on November 7, 1996.

NOTES TO FINANCIAL STATEMENTS (Continued)

ALLOCATION OF PENSION COSTS

If a member's total creditable service was partly earned by employment in more than one retirement system, the cost of the "pension portion" is allocated between the different systems pro rata based on the member's service within each retirement system.

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

The accounting records of the System are maintained on a calendar year basis in accordance with the standards and procedures established by the Public Employee Retirement Administration Commission.

The Annuity Savings Fund is the fund in which members' contributions are deposited. Voluntary contributions, re-deposits, and transfers to and from other systems, are also accounted for in this fund. Members' contributions to the fund earn interest at a rate determined by PERAC. Interest for some members who withdraw with less than ten years of service is transferred to the Pension Reserve Fund. Upon retirement, members' contributions and interest are transferred to the Annuity Reserve Fund. Dormant account balances must be transferred to the Pension Reserve Fund after a period of ten years of inactivity.

The Annuity Reserve Fund is the fund to which a member's account is transferred upon retirement from the Annuity Savings Fund and Special Military Service Credit Fund. The annuity portion of the retirement allowance is paid from this fund. Interest is credited monthly to this fund at the rate of 3% annually on the previous month's balance.

The Special Military Service Credit Fund contains contributions and interest for members while on a military leave for service in the Armed Forces who will receive creditable service for the period of that leave.

The Expense Fund contains amounts transferred from investment income for the purposes of administering the retirement system.

The Pension Fund contains the amounts appropriated by the governmental units as established by PERAC to pay the pension portion of each retirement allowance.

The Pension Reserve Fund contains amounts appropriated by the governmental units for the purposes of funding future retirement benefits. Any profit or loss realized on the sale or maturity of any investment or on the unrealized gain of a market valued investment as of the valuation date is credited to the Pension Reserve Fund. Additionally, any investment income in excess of the amount required to credit interest to the Annuity Savings Fund, Annuity Reserve Fund, and Special Military Service Credit Fund is credited to this Reserve account.

The Investment Income Account is credited with all income derived from interest and dividends of invested funds. At year-end the interest credited to the Annuity Savings Fund, Annuity Reserve Fund, Expense Fund, and Special Military Service Credit Fund is distributed from this account and the remaining balance is transferred to the Pension Reserve Fund.

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 3 - SUPPLEMENTARY MEMBERSHIP REGULATIONS

The Falmouth Retirement System submitted the following supplementary membership regulations, which were approved by the Public Employee Retirement Administration Commission on:

March 11, 1999

Effective this day... any active member of the Falmouth Retirement System who can prove prior seasonal, temporary or otherwise non-eligible service as an employee of the Town of Falmouth will be allowed to purchase this type of service as long as documentation can be recovered to support this type of employment and the member is an active member of this system. The following information will be required to support and calculate contributions owed, plus interest, and service rendered: total income gained through this employment; hourly wage received; hours worked; period of time covered. The calculation of creditable service will be based on actual hours worked, the sum of which is to be either reported to this office through payroll records and/or determined using the employees hourly wage as submitted to this office by the Treasurers' records or computer payroll printout indicating total income paid for the period of time worked.

February 14, 1994

Members who have been receiving workers' compensation benefits and return to work under partial workers' compensation benefits and part-time work shall have deductions made on the part-time employment compensation.

Paramedical and EMT Specialization Pay received by Town of Falmouth fire fighters is regular compensation.

September 29, 1993

Members who are receiving partial workers' compensation benefits and return to employment will be required to contribute to the system regardless of the number of hours employed and will receive full creditable service for such contributions. No contributions either from the member or governmental unit will be required with respect to the workers' compensation benefits paid for partial incapacity.

May 18, 1993

Members re-depositing funds or purchasing service credit will be allowed to make payment in one lump sum or in scheduled installment payments made directly to the retirement system as approved by the retirement board. If installment payments are made, service credit will be applied to the member's record upon final payment.

June 25, 1991

Members who have previous CETA employment on which no retirement deductions were taken due to ineligibility for membership at the time of that employment based on its temporary nature, will be allowed to pay late entry make-up payments and receive creditable service for such CETA employment. Excluded will be intermittent sporadic employment of limited duration and the type

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 3 - SUPPLEMENTARY MEMBERSHIP REGULATIONS (Continued)

of service that would not create an expectation that he/she would become entitled to the right to membership in a Massachusetts retirement system.

December 19, 1986 Rule Governing Creditable Service

“Any person who becomes a member, who was eligible to join the system on July 1, 1941, the effective date of the Falmouth Retirement System, or who was not eligible to join because of the type of employment, who claims any previous period of part-time, provisional, temporary, temporary-provisional, seasonal or intermittent employment or service shall be credited with an accumulated total of actual time worked. The accumulated total shall be credited in full months and any fraction thereof shall be credited to the nearest full month. Nothing in this rule shall be construed to prevent any member from claiming creditable service under any other provisions of Sections one to twenty-eight inclusive of Chapter 32 of the General Laws.”

Minimum Annual Compensation and Minimum Hours

“In all cases involving part-time, provisional, temporary provisional or intermittent employment or service of any employee in this governmental unit, the board shall have and exercise full jurisdiction to determine such employee’s eligibility for membership; provided that any person holding a position for which the annual compensation is fixed in an amount of two hundred dollars or less, and/or the duties of such person require less than twenty hours, regularly, in the service of this governmental unit during the regular work week of permanent or temporary employment shall not be eligible for membership.”

Permanent - Intermittent Service

In all cases involving a part-time provisional, seasonal or intermittent employment or service of any employee, including such employment or service in a municipal office or position, the Board shall fix and determine the amount of creditable service provided that one full work week as defined for such position by a collective bargaining agreement, the Town of Falmouth Salary Administration Plan or Department of Education, equal one full work week of creditable service and that any lesser period shall receive the applicable percentage of creditable service; provided that in the case of Food Service Workers employed in the school lunch program and other full-time school department employees (except teachers), the Board shall credit as the equivalent of one year of service actual full-time service of not less than eight months, and provided further that in all other cases, the board shall credit as full time service (one year) all other actual full time service of not less than nine months, provided that the board shall credit as full time service not to exceed five years that period of time during which a reserve or permanent intermittent police officer or a reserve, permanent intermittent or call firefighter was on his respective list and was eligible for assignment to duty subsequent to his appointment; and, provided, further that such service as a permanent-intermittent or call fire-fighter shall be credited only if such permanent-intermittent or call fire-fighter was later appointed as a permanent member of the Fire Department.

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 4 - ADMINISTRATION OF THE SYSTEM

The System is administered by a five-person Board of Retirement consisting of the Town Accountant who shall be a member ex-officio, a second member appointed by the governing authority, a third and fourth member who shall be elected by the members in or retired from the service of such system, and a fifth member appointed by the other four board members.

Ex-officio Member: Maryellen Alwardt

Appointed Member: Robert Whritenour Term Expires: Indefinite

Elected Member: Paul Brodeur Term Expires: 12/04/2008

Elected Member: Russell Ferreira Term Expires: 10/30/2010

Appointed Member: Ellen Philbin Term Expires: 06/30/2009

The Board members are required to meet at least once a month. The Board must keep a record of all of its proceedings. The Board must annually submit to the appropriate authority an estimate of the expenses of administration and cost of operation of the system. The board must annually file a financial statement of condition for the system with the Executive Director of PERAC.

The investment of the system's funds is the responsibility of the Board. All retirement allowances must be approved by the Retirement Board and are then submitted to the PERAC Actuary for verification prior to payment. All expenses incurred by the System must be approved by a majority vote of the Board. Payments shall be made only upon vouchers signed by two persons designated by the Board.

The following retirement board members and employees are bonded by an authorized agent representing a company licensed to do business in Massachusetts as follows:

Treasurer - Custodian:)	
Ex-officio Member:)	\$50,000,000 (Fiduciary Liability)
Elected Member:)	\$1,000,000 (Fidelity Bond) Employee Dishonesty
Appointed Member:)	Issued through MACRS as a rider to a blanket policy
Staff Employee:)	Travelers, National Union Fire, Arch

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 5 - ACTUARIAL VALUATION AND ASSUMPTIONS

The most recent actuarial valuation of the System was prepared by the Public Employee Retirement Administration Commission as of January 1, 2006.

The actuarial liability for active members was	\$59,563,758
The actuarial liability for retired and inactive members was	<u>46,903,421</u>
The total actuarial liability was	106,467,179
System assets as of that date were	<u>70,680,316</u>
The unfunded actuarial liability was	<u>\$35,786,863</u>
The ratio of system's assets to total actuarial liability was	66.4%
As of that date the total covered employee payroll was	\$24,781,804

The normal cost for employees on that date was 8.26% of payroll

The normal cost for the employer was 6.20% of payroll

The principal actuarial assumptions used in the valuation are as follows:

Investment Return: 8.0% per annum
 Rate of Salary Increase: Varies by service and by job group

GASB STATEMENT NO. 25, DISCLOSURE INFORMATION AS OF JANUARY 1, 2006

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Cov. Payroll ((b-a)/c)
1/1/2006	\$70,680,316	\$106,467,179	\$35,786,863	66.4%	\$24,781,804	144.4%
1/1/2004	\$62,841,919	\$94,608,837	\$31,766,918	66.4%	\$22,751,210	139.6%
1/1/2001	\$56,521,082	\$74,036,963	\$17,515,881	76.3%	\$18,474,744	94.8%

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 6 - MEMBERSHIP EXHIBIT

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Retirement in Past Years										
Superannuation	9	*	*	*	9	11	21	13	11	13
Ordinary Disability	0				0	3	0	0	0	0
Accidental Disability	0				3	3	0	2	2	3
Total Retirements	9	0	0	0	12	17	21	15	13	16
Total Retirees, Beneficiaries and Survivors	244	*	*	271	276	286	321	322	317	327
Total Active Members	538	*	*	659	539	591	635	748	711	647
Pension Payments										
Superannuation	\$1,556,722	\$1,696,537	\$1,985,969	\$2,188,528	\$2,310,705	\$2,430,921	\$2,925,546	\$3,107,029	\$3,319,190	\$3,540,331
Survivor/Beneficiary Payments	100,177	131,838	138,094	117,624	113,416	148,825	171,280	223,151	248,546	185,149
Ordinary Disability	23,472	23,724	28,057	63,259	57,946	128,134	129,813	128,374	129,117	62,925
Accidental Disability	498,758	494,370	504,653	631,253	620,621	698,116	855,683	896,131	951,453	1,095,869
Other	84,530	60,806	53,375	77,206	78,578	84,071	99,629	99,951	148,768	260,516
Total Payments for Year	<u>\$2,263,659</u>	<u>\$2,407,275</u>	<u>\$2,710,148</u>	<u>\$3,077,870</u>	<u>\$3,181,266</u>	<u>\$3,490,067</u>	<u>\$4,181,951</u>	<u>\$4,454,636</u>	<u>\$4,797,074</u>	<u>\$5,144,790</u>

* data unavailable

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